The effect of lobby activities by the financial industry on the accounting quality of new accounting standards

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1. Introduction

Almost every day somewhere financial lobby activities are reported negatively. This will give the idea that lobby activities in this sector have a bad reputation, but is this really the case? Another view is that lobby activities support governmental groups with useful information. The British parliament gives a definition of lobbying:

'*Lobbying is when an individual or a group who tries to persuade someone in Parliament to support a particular policy or campaign.*'

These activities are also occurring at the FASB and IASB, which are the main worldwide accounting standard setters. These standard setting bodies send regularly exposure drafts to the public on which companies and individuals can respond to. These responses are formulated in comment letters (Allen & Ramanna, 2013). Gipper, Lombardi & Skinner (2013) state that companies and other political affiliated persons could also, besides using comment letters, influence the standard setting process with other techniques.

While the intentions of the FASB/IASB's exposure drafts are to gain knowledge about proposed new standards, it is not clear if the respondents are acting in their self-interest and if these responses will actually increase the quality of the new standards. For example, Ramanna (2008) found opponents of a standard proposal for fair value goodwill impairment. These opponents could be related to firms which were also opponents of that same standard. This indicates lobbyists act in a self-interested way for their companies. This is supported by Igan, Mishra and Tressel (2012), who found financial lobbyists who lobbied more, took more risk before the 2008 banking crisis, had a bigger loss after the crisis, and therefore benefited more from a special governmental program. This is consistent with the theory of Sutton (1984) who stated that lobbyists will only participate in the debate if the expected benefits exceeds the costs. It is not clear from the scientific literature if these self-interested motivations are align with the goal of the FASB and IASB to increase knowledge and eventually the quality of an accounting standard.

The IASB explains on its website that it will prepare an exposure draft within the institution, and then asks for the public opinion. After receiving responses, the IASB will identify issues that were mentioned in the comment letters, check if the issues are understood correctly and considers if these issues are analyzed sufficiently to form a conclusion about the changes that possibly should be made in the new standard (IASB, 2017). This can cause a mismatching between what an industry

wants and what will increase the quality of accounting standards. Therefore this study will answer the following main research question:

Will the quality of accounting standards be affected by the lobby activities of the financial industry which are motivated by self-interested incentives?

To find the answer to this question, this study will divide the research area into three sub-questions. At first, the study will try to find an effect between lobby activities and the creation of a new standard, which will be measured by an increase and/or decrease of both reliability and relevance, following the research techniques used by Allen & Ramanna (2013). This possible relation could be influenced by self-interested motivations from an specific industry, which will be the second sub-question. Finally, the relation between lobby activities and the reporting quality is studied. These three explanations should give an answer to the research question when they are merged.

This study will contribute to the literature by focusing solely on the financial industry, which will give an understanding of how financial reporting standards affecting this industry will be influenced by them. Also because the financial industry has a significant influence on the economy, it is important to know if this industry is managing the accounting standards in their favor while there is the possibility this may decrease the quality. Also, the financial industry is often excluded from data samples because it reacts differently compared to other industries, so it is interesting to focus only on this industry to understand their behavior. Another contribution is the empirical setting, which is not often done in the existing literature about this topic (Allen & Ramanna, 2013; Gipper et al., 2013).

The accounting practice will also benefit from this study because it will gain an understanding of the influence financial institutions have on the accounting standard setting process. This will help standard setters to take into account these effects. It will also show what kind of financial companies will react and what their motivation for this could be. This will give stakeholders another insight into the behavior of different companies.

The methodology follows a descriptive and a comprehensive analysis of comment letters sent by financial institutions as a response of exposure drafts issued by the IASB to determine the amount of influence and the preference of these institutions to increase the relevance or the reliability of new standards. Therefore exposure drafts of IFRS 9 will be used because this standard

has the biggest impact on the financial industry so far. These results will be used in a multivariate regression analysis to point out the variables which explain these influences and preferences. Related to the third sub-question, a second set of regression analyses should be performed, whereby the relations combined function as an explanatory variable for the reporting quality variables.

The data collection for the first and second sub-question is manually done. On the website of the IASB a database with all comment letter received by the IASB is available. These comment letters are divided among the corresponding proposal from the IASB, so it can easily be connected to the right phase of the creation of IFRS 9. From here, the comment letters are analyzed and it is determined which preference these comment letters hold. This way of analyzing is subjective, so a second observer will do this analysis to cancel out subjectivity. For the third sub-questions, it was hard to collect data by the time of writing this thesis, since most companies would not implement IFRS 9 before the mandatory implementation date of 1 January 2018. This posed a problem for answering this sub-question.

Both regression models for sub-question one and two are insignificant. This is caused by the small amount of data available, but since I used almost all comment letters sent to the IASB, this data includes a large part of the total population. Although both models are insignificant, for the first sub-question the outcome showed a significant influence for profit driven companies. This means profit driven companies have a significant influence on the IASB at the creation of IFRS 9, were non-profit driven firms did not have such an influence. The second sub-question did not have any significant outcome, which means the specific industries included in the regression analyses did not have a common preference within each industry. For the third sub-question the lack of data caused a lack of regression analysis. Therefore nothing significant can be said about the effect on the quality of the accounting standard by lobby activities. Although this is not quantitative analyzed it has to be mentioned that the lack of data for the insurers, which was created by a higher complexity due to the lobby activities, seems to cause a decreasing quality reliance of IFRS 9. This effect was not found for banks and therefore for this sub-group no conclusion could be given.

This thesis presents the juridical background, theoretical background and prior literature in section 2 and 3 respectively. From this, the hypotheses will be developed based on three sub-questions. This will be followed by the methodology which will present per question the research tools which will be used. This section concludes with the data selection. Section 5 will present the

results and give a broad analysis of the outcomes of this research. Finally, section 6 will conclude the study with a conclusion and limitations as well to give direction to future research.

2. Juridical background

This study has its main focus on the lobby activities for IFRS 9 which is implemented completely on 1st January 2018. The reason for this choice is the importance for the financial industry, as IFRS 9 core concepts are based on financial assets and financial liabilities. Although this standard is applicable to a lot of companies, financial companies have to deal a lot more with this standard since they encounter much more financial instruments and products. This higher level of importance rationalizes the expectation that they will lobby more for this standard. This paragraph gives an overview of the proposed regulation of IFRS 9 and the changes with its predecessor IAS 39.

2.1. The history of the IASB

The International Accounting Standard Committee (IASC) was founded in 1973 due to the growing internationalization of capital markets and was an ambitious initiative of partners in accountancy firms, financial executives of companies, staff members of accountancy bodies and academics who create standards next to their jobs (Camfferman & Zeff, 2007; Zeff, 2012). The IASC created many international accounting standards (IAS) during its existence.

According to Camfferman and Zeff (2007) and the IFRS Foundation (2008), the IASC started in 1988 with the processing of financial instruments in a standard. This was motivated by a growing hidden risk which was brought by new unknown financial instruments, which developed fast during that time. Prior to this date, financial instruments were included in some standards, for example, Foreign Currency in IAS 21 and disclosures of the financial statements of banks in IAS 30, but were not intensively worked out. IAS 39 was finally approved in 1998. This standard was only meant to be a temporary solution as it was almost totally based on the US regulations (Zeff, 2012; Botzem & Quack, 2009; Whittington, 2005).

In 2001 the successor of the IASC was founded. It was due to the decision of the European Commission to implement integrated financial services and a capital market in the European Union which caused a grounded support for the role of the IASC and its standards. When the IASC transformed into the IASB, it already had a supportive clientele for its standards because of the commitment of the EU, which no other country has done until that point (Zeff, 2012). From this point, standards were formed by the International Accounting Standards Board (IASB), an independent non-profit organization whose main goal is to create a set of rules that would apply

equally to the financial reporting practices of all companies worldwide (Ball, 2006), which is still working with national accounting standard organizations to successfully create these standards (Fontes et. Al., 2005).

The commitment of the EU for the IASB came from a demand for a unified set of accounting standards. This came with the advantage of an internationally credible set of rules which gave European investors immediate access to international capital markets (Whittington, 2005). The IASB revised its standards and changed it in International Financial Reporting Standards (IFRS). The new IFRS standards and the not revised IAS regulations were implemented in the EU in 2005. After that period other countries followed (Schipper, 2005; Whittington, 2005; Zeff, 2012). On 1 January 2018, IFRS 9 was internationally implemented, but this was not achieved easily as it will be discussed in the next subsections.

2.2. Lobbying for/against IAS 39

According to Ball (2006), IAS 39 requires fair value for financial instruments other than loans and receivables that are not held for trading, securities held to maturity, and qualifying hedges. This standard is used for recognizing and measuring financial assets, financial liabilities, and some contracts to buy or sell non-financial items.

In 2003 and later in 2005, the IASB issued an improved version of the standard. Zeff (2012) and Whittington (2005) describe that during this time, the EU had already decided to adopt the rules for every EU country. So in France, banks did not accept that they could no longer use hedge accounting on significant hedged positions. Even the president of France lobbied with the reason that the changes in the standard could damage Europe's financial stability. Zeff (2012) makes clear that the IASB still issued the improved standard, even with the fact that the president of France mostly has a big influence on policymakers in the EU.

Another example given by Zeff (2012) shows the controversy of IAS 39. During the same period, the European Central Bank (ECB) responded to the 'full fair value option' for measuring financial assets and liabilities. The IASB wanted to give in to the ECB, but it was already too late when the European Commission implemented the whole standard before the IASB could issue a modification. This resulted in carve-outs into the standard (Zeff, 2012; Ball, 2006).

Lobbying too resulted in 2003 into discussion series with the IASB where banks and other interested persons could discuss IAS 39 directly with the IASB. According to Whittington (2005), this was achieved by European banks who did not feel heard when they responded to the exposure draft of improvement for IAS 39. Although the IASB took these responses into their process, the banks started a campaign where politicians were involved. This resulted in a different approach of the IASB to include criticism.

In a staff paper of the IASB (IFRS Foundation, 2013) it is stated that a proposition to introduce a narrow-scope exception to the requirement for the discontinuation of hedge accounting in IAS 39 and IFRS 9 was received positively. The majority who responded on the Exposure Draft of the IASB agreed. The ones who did not agree argued the proposed changes were not necessary. This shows that lobby activities do not only takes the counter side of a proposed standard change.

2.3. From IAS 39 to IFRS 9

In 2008 the IASB published a discussion paper to change IAS 39 due to lobbying activities from different parties to develop new standards for financial instruments that are principle based and less complex (IFRS Foundation, 2008). The purpose of this discussion paper is, besides to answer the high demand for new financial based standards, to create improvement of the requirements for measuring financial instruments and hedge accounting and to make new standards less complex. Problems which should be resolved were: complex criteria for measuring financial instruments and the difficult application, not all instruments had clear requirements, it was not always clear when management should account for a specific financial asset or liability, different measurement methods caused different profits, it was not always possible to reconstruct which choices of measurement were used, and these standards were very time consuming for involved parties (IFRS Foundation, 2008). This discussion paper was an invitation for different stakeholders to react on the proposed changes and to inform the IASB about potential demanded improvements.

IFRS 9 consists of three phases which were all three finished in a different period (IFRS Foundation, 2014). Phase 1 describes classification and measurement for the financial assets and liabilities. There is one principle-based approach instead of multiple rule-based approaches which were complex to implement. This new approach classifies assets based on business models and the nature of cash flows. IFRS 9 will also break down the multiple impairment models to only one

model, which will be applied to all financial instruments and remove complexity. Another modification is that own credit gains and losses will be presented in other comprehensive income for fair value option liabilities, instead of presentation in profit and loss. Phase 2 contains a new expected loss impairment model, which will be recognize expected credit losses in a more timely manner. This recognition can be done from the first moment financial instruments are recognized and during the lifetime of the expected losses, it will lower the threshold. Phase 3 is focusing on hedge accounting. The new model for hedge accounting enables companies to better assess risk management activities by aligning the accounting treatment with these activities. Users of financial statements will be better informed about the effects of hedge accounting (IFRS Foundation, 2014).

2.4. Responses to IFRS 9

After the 2008 discussion paper, the IASB decided to divide IFRS 9 into these three phases. For each phase, the IASB issued discussion papers and exposure drafts upon which stakeholders could respond, and received in return comment letters from these respondents. This subsection will discuss responses for each phase.

In phase 1 classification and measurement were discussed during the discussion papers and exposure drafts. This was a response to the first discussion paper in which the IASB explained it would change IAS 39 into a new standard to simplify the accounting rules around financial instruments. The IASB wanted to implement a fair value measurement for all financial instruments. Most users of financial statements supported this idea because according to them, fair value could better represent the effects on economic events, for example if financial products like derivatives are less valuable than there book value in the market due to negative market fluctuations. The fair value in this situation then shows the real market value of that particular product.

Most preparers, for example big international companies and several controller associations, and auditors, for example the Big4 and smaller audit firms, were against this proposal and substantiate that the mixed-attribute model better reflects business activity (IFRS Foundation, 2009a). The IASB decided this proposal is not the most appropriate approach. So in the following exposure draft, it was stated that classification requires financial instruments to be measured at fair value or amortized cost. Although this proposal does not eliminate all the complexity, the IASB believed it would be easier for users to understand the financial statements compared to the

situation before, and gives users better information for specific types of financial instruments in particular circumstances (IFRS Foundation, 2009b).

Due to the complexity of this standard, many respondents of the exposure draft such as big international banks, insurers, and associations of multiple accounting disciplines, argued the IASB should slow down in creating this new standard. Other concerns were about the decision to divide this standard into three phases, which according to these respondents did make it harder to respond correctly in this phase due to the lack of future information about the other two phases. This also caused accusations that the IASB was too much focused on banks, while insurance practices would be handled in the second phase (IFRS Foundation, 2009c). In a later exposure draft, the IASB decided to retain most of the existing classifications of IAS 39 for financial liabilities. Many of these respondents agreed this was the best suitable solution and no other alternative explored by the IASB was less complex. Several respondents also argue the problems during the financial crisis were primarily caused by financial assets, so there was no pressing need to change IAS 39 related to financial liabilities.

Phase 2 mostly build on the discussion papers prior to phase 1 but adapt the impairment model in some exposure drafts. The IASB and FASB tried to combine this phase, but for the IASB the proposals applied to financial assets measured at amortized cost that are managed in an open portfolio, while this was not the objective of the FASB. The common proposal includes features which partly satisfy the primary objectives of both parties. This created an agreement on the importance of convergence, but respondents also stated it was difficult to converge if both boards have differing objectives. The disagreement came on the proposal to divide loans into two groups. Loans which will be recognized as expected credit losses over a time period were mentioned 'good book', and other loans referred as 'bad book'. This difference results in another way of recognizing an impairment allowance. The disagreeing respondents, which mostly consisted of different associations (insurers, actuaries, etc.) argued this proposal is related to internal credit risk management methods and procedures. Nonfinancial companies (others than banks, insurers and asset management companies) clarified their financial assets differ greatly from those of financial institutions and therefore will result in an inconsistent practice. Some respondents argue this proposal will not be appropriate for trade receivables and insurance portfolios. Trade receivables were left out of the scope of the proposal, but other respondents responded it would be costly and

complex to implement this impairment model. They provide the idea of a separate and simplified impairment model. Most insurance companies argue the proposed model of 'good and bad books' will work for banks, but is less accurate than their own models, and will give less meaningful information due to the consideration of their holdings on a portfolio basis instead of an individual basis (IFRS Foundation, 2011). From this arguments, the IASB decided to create a voluntary deferral option for insurers. This way insurers who qualify for this option, if a predominant part of their liabilities is created by the activities of issuing contracts which are in scope of IFRS 4, could postpone IFRS 9 until a new insurance contracts standard would be implemented. When insurers do not use the new insurance contracts standard when it will be implemented on 1st January 2021, they have to implement IFRS 9 mandatory (EY, 2015; PwC, 2015).

Phase 3 also started with the discussion paper prior to phase 1. Most respondents including big international banks, insurers, and associations of multiple accounting disciplines, disagreed with the proposal in this discussion paper to eliminate hedge accounting or partial hedges. The prime reason given was these new methods introduce new complexities. As second, it was mentioned that the IASB should first finalize classification and measurement (Phase 1) before starting change hedge accounting methods. Other respondents who supported the change of the fair value hedge accounting method also supported the fair value valuation for all financial instruments method, because after the implementation fair value hedge accounting was not needed anymore (IFRS Foundation, 2009a), which makes it easier to conduct.

After a few exposure drafts and comment periods, the IASB created a new hedge accounting model. This new model aligns hedge accounting more closely with risk management activities, both at financial and nonfinancial risk. New in IFRS 9 is the principle-based approach of not distinguishing between types of items, this alleviation was required by respondents (IFRS Foundation, 2013a; 2013b). This will let more entities implement and make use of hedge accounting practices to reflect their actual risk management activities. The amount of analyses that is required to implement hedge accounting will be decreased so implementing will be more accessible. This new model also included improved disclosures for hedge accounting. This information was provided by the type of a hedge. Users of financial statements like several investors and analysts argued this was confusing, so the IASB changed the information for all hedges to one single location in the disclosures (IFRS Foundation, 2013b).

The effective date of these phases was originally 1 January 2015, but in response to the exposure draft 'Expected Credit Losses', many respondents requested the IASB to defer this date. This lobbying activity was supported by the uncompleted phase 2, after which the IASB decided to set another date to give companies sufficient time to prepare for applying IFRS 9. The new mandatory date was set on 1 January 2018. Before this date, it was possible to implement IFRS 9 voluntarily from Financial year 2015 until the mandatory implementation date.

Now the history of IFRS 9 is described, it is necessary to describe the practice of the accounting standard setter (in this case the IASB) and how the standard setter give respondents the opportunity to provide feedback on the proposals.

2.5. The practice of the accounting standard setter

Financial accounting standards play an enormous role when it is necessary to have some insights into a company. Many stakeholders for example, shareholders, employees, governmental institutions, tax agents, financial analysts and potential investors are all served by these accounting standards when assessing a company's financial statements. These accounting standards are increasingly used with an international perspective. Fontes, Rodrigues, and Craig (2005) mention that local General Accepted Accounting Principles (GAAP) in different countries are increasingly adopting a more international orientation to adjust to the international financial reporting standards (IFRS), created by the IASB. Like said before in section 2.1, the IASB is working with national accounting standard organizations to successfully create these new standards (Fontes et. Al., 2005).

IFRS does have a principle-based orientation, which specifies broad requirements combined with the application of professional judgment (Barth, Landsman, Lang & Williams, 2012; Agoglia, Doupnik, & Tsakumis, 2011). This leaves room for managers of the firms to make any accounting decision that does not infringe the principles as stated in the standards (Carmona & Trombetta, 2008). This is in contrast with a rule-based system, which is often implemented in local GAAP such as the US, and which is characterized as a very detailed guidance with clearly defined thresholds and structures which keeps the reporting decisions in balance (Agoglia et al., 2011; Nelson, 2003). This difference in approach gives discussions in the creation of IFRS which is described in paragraph 2.

The IASB develops its standards with a six-step approach, namely (1) Setting the agenda, (2) Planning de project, (3) Developing and publishing the Discussion Paper, including public consultation, (4) Developing and publishing the Exposure Draft, including public consultation, (5) Developing and publishing the Standard and (6) Procedures after a Standard is issued (IFRS Foundation, 2017). There is a possibility for stakeholders to lobby on the standard during steps three and four. They can respond to these Discussion Papers and Exposure Drafts with the use of comment letters which are assessed by the IASB and being evaluated for any unseen problems, whereby the IASB could alter the statement or carry out step three and/or four again. This makes it possible for anyone who is interested to steer a new financial statement in one particular desirable direction.

2.6. Summary

The IASC was founded in 1973 and from thereon transformed into the IASB as we know it today. The transformation from the ISA 39 rules to the IFRS 9 rules came with a lot of different opinions from the respondents as described in this paragraph. Although much differences existed, the IASB has implemented the new IFRS 9 internationally on 1 January 2018 after processing the feedback from three different phases. These three phases were 1) classification and measurement of financial instruments, 2) a new impairment model, and 3) hedge accounting. The IASB let respondents provide feedback on proposals, and in return the IASB will process this feedback into the adapted proposal and let respondents provide feedback on that new proposal.

This seems like a good organized system which works out for the IASB as a standard setter, but what is the incentive for the lobbyists? Is the group of respondents biased with particular characteristics of the lobbyists? And is there a well-defined strategy to lobby within the feedback structure of the IASB? All these questions will be discussed in the following paragraph which will set out the idea of lobbying.

3. Theoretical background

This paragraph will give a theoretical explanation of the different strategies and motivations which can support lobby activities. The three hypotheses which will be used to answer the three sub-questions will follow from this background. While it seems from this history that parties only lobby for their own need, the theoretical explanation will mention other reasons. Also, the technique to lobby and strategies can differ. This paragraph combined with paragraph 2 should give a more extended explanation about the lobby activities of IFRS 9.

3.1. The effect of lobbying

The question is why someone would be interested to influence the direction of a new financial statement. Watts and Zimmerman (1978) assume in their paper that actors participate to maximize their own utility in the end. This simple implication does not explain to what extent people are motivated to fulfill this goal. As a logic consequence of trying to influence standard setters, it will cost the lobbyist a certain amount of money. So in general it can be said that a lobbyist buys influence, which he/she will see as lobbying costs. Sutton (1984) explains that only lobbyists who expect large financial benefits are willing to lobby despite these high costs, which is a rational decision. He continues that these benefits will not only benefit the lobbyist but is also a public good for non-lobbyists who share the same aims. This takes away the incentives for non-lobbyists to bear some of the lobbying costs (Sutton, 1984; Georgiou, 2010). This creates a free riding problem because an individual will not participate in a collective action and achieve a public good. Only when selective incentives are introduced, the free riding problem could be solved (Durocher, et al., 2007; Lindahl, 1987). Therefore the lobbyist will only lobby if his share of the expected benefits is large enough to exceed his sole contribution to the total costs, which again is a rational decision. These expenses will increase if the opportunity costs of not lobbying are higher and when the standard setter is more open to being influenced (Sutton, 1984). From this, it can be reasoned that if the IASB will publish multiple discussing papers and exposure drafts (repeating step 3 and 4) during the development of a particular standard and/or the subject of a standard have consequences for a bigger part of the financial statements, the lobbying costs will be higher. From this rational, a lobbyist will only start to lobby if he/she thinks the lobby activities has an impact, but this does not have to be true.

While it seems lobby activities are not performed if companies don't foresee an impact on the accounting standard setting process, this is only the perception of the lobbyists. To support the existing literature on the effect of lobbyists on standard setters, the following hypothesis, specified on financial companies, will capture the support of the above rationale:

H1: *The banks and financial institutions have a significant impact on the accounting standard setting process.*

3.2. Motives and characteristics of lobbyists

There are many motives for lobbyists to start lobbying. This can vary from personal incentives to doing the good for the community. This is highly dependable from the characteristics of a lobbyist. Also the effect of lobby activities can be determined by several components. This subparagraph will discuss both motives to lobby and the characteristics which determine the argumentation of respondents.

3.2.1. Motives to lobby

Motives to start lobbying could be changes or proposals of new standards which will change the future tax effects in the financial statements, change regulations which can be determined on and affect accounting outcomes, change political costs which can result in higher costs for the company or a movement in the operating industry, change information production costs which are the costs of keeping accounting books up to date and change management compensation plans which affects managers' personal wealth (Watts & Zimmerman, 1978; Tutticci, Dunstan & Holmes, 1994). Gullberg (2008), and Elbannan & McKinley (2006) discuss that the gathering of information about a decision makers' preference and avoid information uncertainty about future changes could also be reasons for companies to lobby. This can be matched with the need to hold close long-term relationships with decision makers to minimize this information uncertainty. This relation can be described as a principal-agent relationship from the agency theory. The agency theory explains the logic of a relation between a principal and the agent who works for the principal (Ross, 1973; Eisenhardt, 1989). In this case, the IASB can be seen as the principal who is reliable on the feedback from the respondents. The respondent is the agent. The principal has no or little knowledge of the true intentions of the agent and the agent will act in a way which suits him best (Ross, 1973;

Eisenhardt, 1989). Regarding to the lobby activities, the IASB will never know for sure the true intentions of the respondents and the respondents will always act in a way it will benefits them most as described above. It is the beneficial for the principal to minimize the information uncertainty between his goal and the intentions of the agent and in return the agent should gather information about the principal's preferences (Ross, 1973; Eisenhardt, 1989). The IASB has little possibilities to decrease the information uncertainty. While it can be said the auditors of the big4 and smaller audit firms can minimize this information gap, it is not unlikely they also have their own incentives to act for their own needs. On the other hand, the respondents have multiple ways to gather information about the IASB preferences to make their lobby activities the most successful.

These motives and a cost-benefit analysis based on expectations are the starting points for firms whether they should lobby and for which standards. Firms should decide when they sent a comment letter or doing other lobby activities to achieve the highest possible effect.

The IASB give notifications prior to the first step about possible changes or implementations of financial standards. Sutton (1984) and Stenka & Taylor (2010) claim lobby activities do not only occur in the comment invitation period shaped by step 3 and 4 of the standard setting process. Sutton (1984) explains firms also lobby before a standard is even proposed due to lower lobbying cost and a higher probability of success when the standard setter is still unbiased in comparison to the period after the exposure draft when the standard setter is influenced by the collective view of other lobbyists. This will shift the cost-benefit relation. This can be done by subsidizing the standard setters with information to steer his opinion in the favor of the lobbyist prior to the creation of a new standard (Sutton 1984). This reasoning of an early timing is supported by Gullberg (2008), and Giner & Arce (2012) where the latter concluded in their first part of study that twice the amount of lobbyists was sending letters during the third stage instead of the fourth stage where they believe the effectiveness of lobbying is greater when the authors tested this the first time. Only preparers sent more letters in a later phase. Sutton (1984) acknowledge some firms also lobby in the post-exposure draft period due to a change of their own opinion or uncertainties of shifting rules in the industry. So when the Giner & Arce (2012) excluded the preparers in their second test, the conclusion reversed and showed more letters were sent during a later phase. This was also found by Georgiou (2010). In comparison to these results, Jorissen, Lybaert, Orens & Van der Tas (2012) find corporate preparers and preparers from the financial sector prioritize their focus on lobby

activities during the last stage in the standard setting process which emphasize the importance of a later participation. So it seems the timing of lobbying is shifted over time and nowadays there is a focus mainly on a later stadium, and especially for the preparers of the financial statements in the financial sector.

3.2.2. Characteristics of lobbyists.

As already slightly mentioned, there are two types of lobbyists according to Sutton, Georgiou, Giner & Acre and Jorissen et al., namely the users and preparers/producers of the financial statements (Sutton, 1984; Georgiou, 2010; Giner & Arce, 2012; Jorissen et al., 2012). It can be said there is also a third group of lobbyists, namely the auditors. Since they not preparing or using the financial statements, there are left out of traditional literature. It should be considered that auditors will lobby for both preparers and users, since it is assumed auditors need to verify both the correctness of the prepared numbers and the completeness/understandability for the end users of the financial statements.

Producers are more influenced by a new standard's economic effects because they have a less diversified income stream. Therefore their lobby activities are bigger while they expect their lobbying efforts are more profitable. Another reason for this statement is the general assumption most producers are wealthier than the users of financial statements, so they could bear more lobby costs (Georgiou, 2010). Producers typically generate a greater interest in standards which alter the measurement of earnings or valuation of assets and liabilities, for it hit them the most (Sutton, 1984).

The users are normally less influenced by these changes due to a more diversified portfolio and because users are in general smaller than producers (Durocher, Fontin & Coté, 2007). Shifting in financial disclosure rules will arouse interest among users and auditors because this will influence the usefulness of the financial statements in decision-making processes, which also follows a change in reliability and relevance (Sutton, 1984; Jonas & Blanchet, 2000; Allen & Ramanna, 2013). These reliability and relevance components are both assessed by auditors to give assurance to users that the producers will comply to the reporting regulation and give a true and complete view of the year-end financial outcomes.

According to Jonas & Blanchet (2000) reliability consists of (1) Predictive Value based on earnings persistence and disaggregated information, (2) Feedback Value, and (3) Timeliness of Information. Relevance consists of (4) Verifiability, (5) Representational Faithfulness based on completeness, and (6) Neutrality. These six components could be influenced by the lobbying activities performed by lobbyists who are mostly preparers of financial statements because they have more resources to spend due to their wealthier status (Georgiou, 2010) as stated above.

Due to the wealthy character of preparers, it is thinkable that companies of the financial industry belong to this group. Although this seems true for the most part, there are two notions which should be mentioned here. At first Giner & Arce (2012) mention financial companies like pension funds and mutual funds are not as much affected by the economic effects of financial statements as regular preparers because they have generally a more diversified portfolio than regular preparers and are much less dependent on one sort of income stream. Second, companies in financial industries are also users of financial statements. Stiroh & Rumble (2005) describe that modern financial institutions create complicated structures which include holding companies, commercial banks subsidiaries, and other components. To do this, managers should make strategic decisions, and analyze future subsidiaries and the potential risks these could contain. Multiple studies (Georgiou, 2010; Durocher et al., 2007) showed the low participation of users in comparison to preparers, so it is not clear if financial institutions actually lobby for the users' side.

Reasons for the low participation rate were given by Weetman, Davie, & Collins (1996). They concluded the lack of participation is caused by a traditional habit for not responded ever to a Discussion Paper or Exposure Draft, a lack of time since mostly one person in an organization is pointed to this task, and participation could happen through informal channels which could not be analyzed in a study and so remains unknown. As mentioned earlier, this absence of lobby activities could also be explained by the advantages of free riding with other lobbyists who shares the same goal, since mostly the benefits for users don't exceed the costs of lobby activities (Georgiou, 2010; Giner & Arce, 2012; Sutton, 1984).
Following these ways of reasoning, the following hypothesis will be explored:

H2: *The effect of lobby activities of the financial industry on accounting standards setters is motivated by favorable incentives/self-interested motivation for the financial industry.*

So the relation between IASB and the lobbyists can be seen as a principal-agency relationship where both should minimize their information uncertainty. While the IASB can do not much but is dependent of the general vision of all lobby activities combined, the lobbyist can perform several actions such as lobby on different moments in the process and act as a lobbyist with different intentions (producer vs. user), as described in the next section, to gather an advantage in this relationship.

3.3. The lobbying strategy

As stated above, lobbying activities could influence the components of reliability and relevance. Georgiou (2010) concludes a few methods to conduct these lobbying activities. First of all, a popular method is the use of comment letters. Although it is clear lobbying is not restricted to this form, according to Georgiou (2004) comment letters are a good proxy to measure the lobbying activities since it is one of the few methods for which data is clearly obtainable and observable (Durocher et al., 2007; Stenka & Taylor, 2010). A second method mentioned by Georgiou (2010) is to appeal to a trade organization, which is the most chosen method for lobbying. A trade organization could also send multiple comment letter and could have direct contact with decision makers. The advantage of using this form of lobbying is to substitute the limited knowledge of managers about financial accounting standards. As mentioned earlier, Sutton (1984) stated also the option for the lobbyists to subsidize the standard setter with valuable information to steer his/her opinion into the desired direction. Baumgartner & Leech (1996) also mention media campaigns, mobilizing members and using allied groups as lobby methods which can be used to have a bigger influence on the standard setters.

Knowing now about the methods used to lobby, the next step is to know what are the possibilities to lobby for. Strategies that can be followed are instinctively an agreement or a disagreement with a proposed change in reporting standards (Tutticci et al., 1994). When this is combined with arguments to support the opinions in the comment letters it is called a strategy of persuasion (Giner & Arce, 2012). Based on prior research, they distinguish two kinds of arguments used in comment letters, conceptual arguments and arguments based on economic consequences (Giner & Arce, 2012; Tutticci et al., 1994). Conceptual arguments are mostly related to accounting assumptions of the conceptual framework and the technical issues of the proposed financial

reporting standard. Arguments based on economic consequences are related to the economic changes which will be caused by the changed standard and its implications. Because preparers of financial statements are mostly affected by economic changes caused by accounting changes due to their undiversified income stream, they will often use economic-based arguments. Stenka & Taylor (2010) mention conceptually based arguments will be used when companies have the incentive to create the image of objectivity and professional credibility in the public appearance and want to achieve this with a detailed and conceptually additive submission. These arguments will mostly be used by accounting related firms like the Big4 or accounting regulation bodies.

Although conceptually based arguments are likely to be used by accounting related firms, it can also be a strategy to change between these two. Tutticci et al. (1994) found that lobbyists who disagreed with a proposal are likely to use conceptually based arguments. They follow a strategy of persuading on theoretical rationality which would align with the standard setters' accepted view instead of using self-interested arguments (Tutticci et al.,1994; Weetman et al., 1996). This creates a diversity in the strengths of comment letters which Sutton (1984) describes as a tactic to reach a higher authority. Saemann (1995) acknowledge although the strength of comment letters is important, standard setters are also influenced by the amount of opposing comment letters they receive. The combination of a number of letters sent and the strength of those letters could vary dependent on different proposals and the assessment of importance by the companies.

Tutticci et al. (1994) described proposed changes in the amortization of intangible assets and changes in the time limit of this amortization period which were widely presented in the media as changes with enormous economic consequences for big companies. This was followed by an increase in comment letters' strength. Caused by the high attention and importance, it resulted in more interesting groups participating in the discussion. As mentioned before, lobbyists could lobby by themselves by sending comment letters or perform other lobby activities, or join a trade organization or other sort of lobby groups (Georgiou, 2010; Sutton, 1984; Baumgartner & Leech, 1996). The strategy about how lobbyists should participate in the discussion is also dependent on his/her perception of influence which can differ from the actual influence, as mentioned by Georgiou (2010). He gives an example of institutional investors who are seen by others as highly influential in the standard setting process, but who see themselves as not that influential. This could explain the low participation of some groups and the choice of strategy of others. When the

perception of influence is high and a change of standards can cause severe economic consequences, lobbying could turn into an aggressive form. This is described in Gorton (1991) in which the SEC stopped a proposal in 1977 as a result of heavily lobbying activities during that period.

So conclusively, while there are many levels and strategies lobby activities could occur with different effects, the following hypothesis is stated:

H3: *The influences gained by lobby activities of the financial industry on accounting standard setters will significantly affect the reporting quality.*

3.4. Summary

Lobby activities seem mostly performed out of a self-interested motive although this is not always clear from the comment letters. The IASB asks for reaction and therefore for information from users and preparers about a certain topic. In the creation of IFRS 9 the IASB asked multiple times for input. This input was not only given during the appointed times but also before and after, which can be a strategy from the lobbyists to increase the effect. Other strategies could vary from different kind of lobbying techniques to a different kind of argumentation in a comment letter. The financial industry is involved in other lobby activities, but because comment letters are the most accessible data about lobby activities, this study will focus mainly on them as will be clear in the next paragraph. Through these different techniques and strategies, it is not yet clear what the effects will be on the newly created IFRS 9.

4. Methodology, research design, and data sample

This section will provide the methodology and the used research design. The research design has two objectives. The first will be featured by a descriptive analysis of the first two hypotheses. The aim is to describe the effects and motives of lobbying activities and conclude about these different phenomena. The second objective is to determine the relation between the lobby activities and the change that could arise in the outcome of accounting standards, so featured by an exploratory analysis. This paragraph will be concluded by a brief explanation about the data sample.

4.1. Methodology

In this study, I choose to use a mixed method between qualitative and quantitative techniques. The qualitative techniques are mostly used to analyze the qualitative input, which are the comment letters from financial companies which will be analyzed by qualitative analyze software described in section 4.3. This will be combined with quantitative data represented by numbers from the financial statements of companies. The reason for this methodology lies in the available data for lobbying. Like said before, multiple studies (Durocher et al., 2007; Stenka & Taylor, 2010, Allen & Ramanna, 2013; Gipper et al., 2013) noticed comment letters as the easiest and almost solely available data related to lobbying activities. Therefore there is a need to include also a qualitative component to the methodology to analyze these letters. However, while these comment letters will be the biggest part of the data to analyze, the majority of the analysis in this thesis will be quantitative.

4.2. Research design

The descriptive analysis of the first hypothesis is searching for the relation between the lobby activities and the standard setting process. To come to this analysis, I follow the study of Allen & Ramanna (2013) for analyzing the comment letters. Allen & Ramanna (2013) classify comment letters on increased or decreased reliability and relevance because in general accounting standard setters make a trade-off between reliability and relevance in their standards. Jonas & Blanchet (2000) give an extended definition of reliability and relevance. They state that reliability consists of 1) Predictive Value based on earnings persistence and disaggregated information, (2) Feedback Value, and (3) Timeliness of Information. Relevance consists of (4) Verifiability, (5)

Representational Faithfulness based on completeness, and (6) Neutrality. These definitions give a broader recognition in the comment letters. So in this study, I follow the research design of Allen & Ramanna (2013) to assess the comment letters, but I use reliability and relevance and their components as described in Jonas & Blanchet (2000) to recognize the preferences of the lobbyists. This should enhance the assessment of comment letters and give a deeper understanding of the lobbyist's preferences.

The analysis will be conducted as follows. The text analyzing program QDA Miner will be used to analyze the comment letters sent by financial institutions, for example, banks, pension funds, insurance companies and committees who set out rules for a specific group of companies like the Basel Committee. The program should identify the sentence with the word stems 'relevan' and 'reliab' for relevance and reliability respectively. The other word stems for the components are (1) 'predic' and/or 'persist', (2) 'feedb', (3) 'timeli', (4) 'verifiab', (5) 'faithful' and/or 'complet', and (6) 'neutral'. These eight word stems will help detect the whole sentence including the identified word stem. The program also detects the exact position of the word in the comment letter measured as the word count from the beginning of the document and the total word count in the letter. Allen & Ramanna (2013) believe the sooner the word is used, the more the lobbyist values the importance of reliability and/or relevance. The whole sentence will then be analyzed for three possible outcomes: A) a positive context which means the letter is indicating the proposed standard will increase relevance and/or reliability, B) a negative context which means the letter is indicating the proposed standard will decrease relevance and/or reliability, and C) an irrelevant context which means the word stem is not related to accounting principles. I have analyzed these three outcomes myself. When the first sentence was marked as irrelevant, I analyzed the second sentence and so on until I could conclude all sentences were irrelevant. With a positive or negative context, the data was collected and processed. The word stems (1), (2) and (3) count for an increase or decrease of reliability. The word stems (4), (5), and (6) count for an increase or decrease of relevance.

To verify the correctness of this method, I will let a second independent observer do the same assessment of the comment letters and compare both outcomes. That will give certainty this method is appropriately and objectively conducted. If both assessments differs significantly (more than 10 different), I will let do another independent observer analyze the comment letters and take a mean

of the three outcomes. If there are less than 10 different outcomes, I will exclude these comment letters from the population.

If it is concluded I assessed the comment letters objectively, the outcomes are compared with the corresponding discussion paper or exposure draft. These discussion papers and exposure drafts are analyzed by the proposed accounting standards which are classified as reliability or relevance increasing or decreasing. By this, the comment letters could be compared if they agree or disagree with the effects of the accounting standards.

The increasing- and decreasing rate of relevance and reliability are then calculated with the following equations:

$$Inc\_Relv_{ij} = \mathbf{1} - \frac{WC\_Inc\_Relv_{ij}}{WC_{ij}} \qquad Dec\_Relb_{ij} = \mathbf{1} - \frac{WC\_Dec\_Relb_{ij}}{WC_{ij}} \qquad ..(1) ...(2)$$

$$Dec\_Relv_{ij} = \mathbf{1} - \frac{WC\_Dec\_Relv_{ij}}{WC_{ij}} \qquad Inc\_Relb_{ij} = \mathbf{1} - \frac{WC\_Inc\_Relb_{ij}}{WC_{ij}} \qquad ..(3)…(4)$$

Where:
- $WC\_Inc\_Relv_{ij}$ and $WC\_Inc\_Relb_{ij}$ are the word count from the word stem used in the context of increasing relevance and reliability respectively in comment letter 'i' on proposed exposure draft or discussion paper 'j'.
- $WC\_Dec\_Relv_{ij}$ and $WC\_Dec\_Relb_{ij}$ are the word count from the word stem used in the context of decreasing relevance and reliability respectively in comment letter 'i' on proposed exposure draft or discussion paper 'j'.
- WC_{ij} is the total word count in comment letter 'i' on proposed exposure draft or discussion paper 'j'.

The word position gives an idea about the value for the lobbyist to change or support the direction of a proposed accounting standard. This will calculate the change in relevance and/or reliability which is expected for every discussion period. Where Allen & Ramanna (2013) wants to test whether these effects are dependent of the political preference and tenure of the FASB member, I use these comment letters analysis outcomes to see if the financial industry has a significant effect on standard setters. To accomplish this, these outcomes are compared with the outcomes of the following discussion paper or exposure draft. The changes in effects between these two are summed with the other changes to calculate if these changes combined are a significant part of the total

change from the first proposal to the finalized IFRS 9 standards. These are the dependent variables in the following equation:

$$(\text{Big4; Financial; CL}_n) = \frac{\sum_{n=1}^{\infty} \Delta Inc\_Relv_{j,j+1}}{\Delta Relv_{j0,j+n}} \qquad \text{...(5)}$$

$$(\text{Big4; Financial; CL}_n) = \frac{\sum_{n=1}^{\infty} \Delta Dec\_Relv_{j,j+1}}{\Delta Relv_{j0,j+n}} \qquad \text{...(6)}$$

Where:

- Big4 is a dummy variable to indicate if a company has a Big4 or non-Big4
- Financial is a dummy variable to indicate if a company is active in the financial industry (actually participate in financial transactions and other financial services, excluding advisory and commission activities)
- CL_n is the total amount of comment letter sent by the same company
- $\sum_{n=1}^{\infty} \Delta Inc\_Relv_{j,j+1}$ is the sum of the changes of increasing relevance of comment letter responding to discussion paper or exposure draft 'j' and the following discussion paper or exposure draft 'j+n'.
- $\Delta Relv_{j0,j+n}$ is the total change of relevance between the first discussion paper or exposure draft and the finalized accounting standard.

The above equations only focus on relevance, because it is believed standard setters have to make a tradeoff between relevance and reliability. So it is expected the effect of one will accomplish the opposite effect of the other.

The second hypothesis aims to find out if the effect between the lobby activities of the financial industry on accounting standard setters is motivated by favorable incentives and/or self-interested motivations. For this analysis, I will group the firm in separate industry categories. These groups are 1) the banking industry, 2) the insurance industry, 3) the advisory industry/politics and 4) an general industry group which is used to filter out other firms not related to banking, insurers or advisory. The choice for these groups lies in the differences between the characteristics of these companies. Banks' assets consist mostly of loans while the insurance industry's assets consist mostly of investments. The difference between these two groups and the advisory group is the difference in goals. The previous used population of companies who sent comment letters will be grouped in these categories. Again, this grouping is subjective and should therefore be verified by

a second observer who group also these companies. Any differences will be excluded from the population.

To determine the proper data for the incentives, the incentives should first be determined per category. For banks, Christensen et al. (2015) mention there is a negative correlation between the resistance of early IFRS adoption for banks. They state that IFRS regulation give more transparency and so banks support this. In comparison Gebhardt & Novotny-Farkas (2011) find that after the implementation of IAS 39 impairment rules for losses, the income smoothing behavior of European banks decreased. They mention however that critics of the incurred loss approach say this approach does not reflect all expected credit losses in inherent in loan portfolios. This will prevent banks from report future losses which already known. The recognition of loan losses is postponed up to the default of the borrower. This is unwanted since it leads to higher earning management in early years and lower earnings later on which can be worsened in economic downfall. This makes the earnings cycle of banks' earnings more worse. This has led to criticism from bank regulators and standard setters during the financial crisis started in 2008 and lead to the discussion for fair value measurement for all financial assets (Gebhardt & Novotny-Farkas, 2011). The IASB responded by issuing the already mentioned Exposure Draft ED/2009/12 *Financial Instruments: Amortized Cost and Impairment*. This included a proposal to change which the incurred loss approach to an expected loss approach.

Gonzalez (2005) state that stricter regulation result in more risk taking activities of banks since there is a tendency to increase their incentives. This can be an incentive to lobby for looser regulation.

In this analysis this incentive for looser regulation in the form of fair value measurement instead of incurred losses is quantified by the preference for the relevance component in comment letters. Since relevance consist of 1) predictability, 2) feedback and 3) timeliness and all three increase in the switch from incurred losses to expected loss approach. The predictability increases due to the inclusiveness of the expectations. This will generate a higher feedback for taken actions by management and will increase sensitivity of the timeliness of assets. In comparison reliability will decrease since 4) verifiability decreases since expectations are harder to verify, 5) faithfulness decreases because future expectations are less reliable than occurred situations, and 6) completeness will increase since assets will represent a more complete image of their true value on

any given date. This set the expectations that banks prefer relevance over reliability. In this analysis the bank regulators are also included, since it is assumed they have the same incentives as the bank themselves.

For the insurance industry is it important remain solvent. Cummins, Harrington & Niehaus (1993) describe that insolvency can occur due to reductions of the values of assets and/or an increase in liabilities for claims. They state that an increase of liabilities for claims are hard to estimate, since it is not exactly known when these will occur. On the asset side it is easier to estimate insolvency risk which depends on volatility of the capital market and asset return. This insolvency risk is dependent on the incentives of insurers to reduce this risk by investing in safer assets and hold more capital. However, large decreases in net worth due to these risks can substantially increase the risk of insolvency and reduce insurer incentives. Therefore long term estimates give a more stable view of solvency of insurers, but Severinson & Yermo (2012) say that the change towards a more fair value driven regulation, like IFRS 9, will bring a greater focus on short-term market fluctuations. According to Severinson & Yermo (2012) critics have stated that this will be a pitfall for long-term investments. This will affect the risk-based funding and solvency regulations since such regulations will apply different capital charge to different investments depending on the perceived riskiness of these investments. Insurers need to re-evaluate the risk return profile of their investments as various asset classes. IFRS 9 will help to measure the assets supporting insurance contracts. Severinson & Yermo (2012) state further that this short-term horizon of assets indicates that balance sheets, annual profits and solvency margins will be more volatile and insurers should anticipate in their the allocation of assets, product design, and other business decisions. Insurers therefore have a greater argument for using a long-term horizon on matched discount rates compared to amortized cost assets. While banks are more focused on the short-term and the fact that banks and insurers compete in the same capital market, it will be a disadvantage for insurers to move to a more fair value based approach.

As mentioned earlier, after phase 1 of the standard setting process of IFRS 9, the IASB was criticized for focusing too much on banks. Therefore the IASB changed the full fair value approach to a partial fair value model and give insurers the option to postpone the implementation of IFRS 9.

From this it is expected insurers will focus more on reliability since 4) verifiability will increase due to the long-term and more stable estimates, 5) a higher faithfulness because more stable investments will guaranty higher solvency, and 6) the completeness of information will decrease but give a more stable investing portfolio. It is not expected insurers will support relevance much, because although 1) predictability should be higher for a more stable portfolio, 2) feedback and 3) timeliness should not increase because this increase more uncertainty and volatility in the investments.

For the advisory companies it cannot be said which trade-off between relevance and reliability they would make since it is assumed they want the best for the general users in the financial markets. Since both relevance and reliability will enhance the financial markets, it is hard to say which of the two advisory firms will prefer.

It must be said that companies with advising as their core activities but who are pro banking or pro insurance are grouped in the banking or insurance group since they try to get the best for their industry. On the contrary, supervisory committees, for example the Basel Committee, which are focused on banks, are grouped within the advisory board since they supervise banks and/or insurers and not especially helping them to achieve their personal goals.

The dependent variables for this hypothesis are the same as for the first and second equation because the effect of the comment letters on reliability and relevance still describe the same effect and the importance lobbyist weight the reliability and relevance of a proposed standard. Although it should be clear after the tests of the first hypothesis if this effect is significant or not, the fact lobbyists try to have and believe to have a significant effect does not change. So the tests should answer if the outcome is still significantly the same if the explanatory variables differ, for this hypothesis the three different industry subgroups. For this hypothesis, I change the independent variables for variables which are positively affected by special directions of accounting standards since it is believed firms lobby to increase their preferable direction. Assuming equation (1) and (4) still holds, the following equations describes the relation between preferable direction in the change of relevance and reliability per industry:

$$(\text{Banking; Insurance; Advisory}) = \frac{\sum_{n=1}^{\infty} \Delta Inc\_Relv_{j,j+1}}{\Delta Relv_{j0,j+n}} \qquad \qquad ...(7)$$

$$(\text{Banking; Insurance; Advisory}) = \frac{\sum_{n=1}^{\infty} \Delta Inc\_Relb_{j,j+1}}{\Delta Relb_{j0,j+n}} \qquad \qquad ...(8)$$

Where:

- $\sum_{n=1}^{\infty} \Delta Inc\_Relv_{j,j+1}$ and $\sum_{n=1}^{\infty} \Delta Inc\_Relb_{j,j+1}$ are the sums of the changes of increasing relevance and reliability respectively of comment letter responding to discussion paper or exposure draft 'j' and the following discussion paper or exposure draft 'j+n'.
- $\Delta Relv_{j0,j+n}$ and $\Delta Relb_{j0,j+n}$ are the total changes of relevance and reliability respectively between the first discussion paper or exposure draft and the finalized accounting standard.
- Banking is a dummy variable to indicate if a company belongs to this subgroup
- Insurance is a dummy variable to indicate if a company belongs to this subgroup
- Advisory is a dummy variable to indicate if a company belongs to this subgroup

The third hypothesis will explore the outcome of the influences gained by lobby activities of the financial industry on accounting standard setters. After hypothesis 1 and 2 described the influences and motives to lobby, this hypothesis will analyze the effect these activities have on the reporting quality. The thought is when the reporting quality is decreasing, the accounting standards are less effective.

To analyze the reporting quality, I follow the study of Biddle, Hilary, & Verdi (2009) because they based their proxies on a broad set of prior literature and use proxies which capture most of the financial statements elements which can affect the reporting quality. They use four proxies to analyze this reporting quality. The first proxy is accruals quality based on the model of Dechow & Dichev (2002). They explain accrual quality is based on the assumption that accruals estimate future cash flows. Earnings have a higher level of prediction of future cash flows when the estimation error embedded in the accruals process is lower. The regression of this proxy includes working capital accruals on lagged, current and future cash flows, and the change in revenue.

The second proxy used by Biddle, Hilary, & Verdi (2009) is a modification of the accruals quality measure. This version takes the incremental association of the current accruals and past and

future cash flows over and above the association between current accruals and current cash flows, as explained by Biddle, Hilary & Verdi (2009). The reason is to cancel out the link between accruals and cash flows which are based on opportunistic earnings management. This is measured to do a regression with the simple model of working capital accruals and current cash flows and a second regression with the original model which regresses working capital accruals on the past, current and future cash flows. The standard deviation of the residuals will be calculated from the two regressions in IAS 39 time period and IFRS 9 period. Here I will nclude only companies who adopted IFRS 9 already voluntary. The second proxy is then the ratio of the standard deviations of the residuals from the two models

AQWi = stdDev 1 (Res1)/stdDev 2 (Res2).

The third proxy is a measure for financial disclosure transparency. Although disclosures of financial instruments are arranged in IFRS 7, it is thinkable IFRS 9 will change the way in how to disclose certain instruments due to the changing classification and measurement. This proxy will be computed with the help of the FOG index as a measure of the readability of the disclosures. Li (2008) finds that a large FOG index is related to lower earnings persistence and a lower future profitability. This variable (FOG) will also be multiplied by minus one to show an increase of reporting quality.

The fourth and last proxy Biddle, Hilary & Verdi (2009) use is a combination of the first three proxies by normalizing them and take the average of the three measures. This financial reporting quality index (FRQ index) can be seen as a summary measure.

To make sure these proxies do not fall under for biases, the Biddle, Hilary, & Verdi (2009) include some control variables. They control for cash flow and sales volatility because this could change the relation between accruals and cash flows. Adapted to this study, the cash flow and sales volatility will be controlled for during the IAS 39 and IFRS 9 period. Again only for companies who adopted IFRS 9 voluntarily. This can create a bias due to the voluntary aspect of the adoption, but since this study is conducted close after the official effective date of the standard this bias should be accepted as no results of the effects of mandatory implementation are already available. Other control variables which are included are a measure of the age of the company, the length of the operating cycle, and the frequency of losses. This could explain some accruals estimation errors which could not be related to earnings management. Another control variable is to repeat the

regression with the FRQ index, but without the AQ. This to make sure the results are not driven by AQ (Biddle, Hilary & Verdi, 2009).

These four proxies and the control variables are included in the multivariate regressions which will be performed for the period before voluntarily adoption of IFRS 9 and the period after this voluntarily adoption. The formula for both periods is described as follows:

$$\Delta \textbf{ Accounting Quality} = \alpha + \beta_1 \big(AQ_t - AQ_{t-1}\big) + \beta_2 \big(AQWi_t - AQWi_{t-1}\big) +$$
$$\beta_3 \big(FOG_t - FOG_{t-1}\big) + \beta_4 \big(FRQ\ index_t - FRQ\ index_{t-1}\big)$$
$$+ \gamma_1 \big(\sigma C\&S_t - \sigma C\&S_{t-1}\big) + \gamma_2 \big(Age_t - Age_{t-1}\big) +$$
$$\gamma_3 \big(OC_t - OC_{t-1}\big) + \gamma_4 \big(freq\_loss_t - freq\_loss_{t-1}\big) + \varepsilon \qquad \dots (9)$$

Where:

- AQ is Accrual Quality
- AQWi is the Modified Accrual Quality
- FOG is the Gunning FOG Index
- FRQ index is the normalized averaged outcome of AQ, AQWi, and FOG
- σC&S is the volatility of the Cash flows and Sales
- age is the age of the company
- OC is the length of the Operating Cycle
- freq_loss is the frequency of the losses of a company
- Δ Accounting Quality is the change in accounting quality between period t and period t-1

These three research designs will give the outcomes on which the answers to the sub-questions are based. From there the main research question will be answered.

4.3. Data sample

Data is collected from different databases. The comment letters, discussion papers, and exposure drafts are all coming from the database of the IFRS Foundation. This website contains documents of the IASB. The comment letters are sorted by IFRS standard wherein again sorted by discussion paper or exposure draft they are relating to. This makes it easy to combine this data. The website of the IFRS Foundation is held by the IASB what guarantees the data is reliable because of their goal to be transparent.

In total I gathered 208 comment letters for all three phases of the IFRS 9 responding process. After processing all the data, the final population consist of 155 comment letter observations from 99 different parties. This drop in population is due to the fact that some comment letters were duplicates, some comment letters were not recognized by the text analyzer program QDA miner and other comment letters did not have a clear direction towards one of the stems for both relevance and reliability or were cancelled out due to the subjectivity verification by the second observer.

In the final population of 155 comment letters, the word stems placement in the text was counted and compared to the total words count of the whole document. The word count was divided by the total word count. This amount was subtracted from 1 to create a percentage which indicates that the sooner the word stem occurred (so the numerator is relatively small compared to denominator) the higher the percentage will be to show the strength of the word stem.
After this calculation was done for every comment letter in every phase, the results are now lined per company. This resulted in 99 companies who responded at least 1 time.

Data used for the second hypothesis relies also on the data for hypothesis 1. For the dummy variables which will be used, the grouping in banking, insurance and advisory is based on the company's website and/or general knowledge of the companies profile in the economic market. Due to the subjectivity test of the second observer, two companies were excluded from the 99 companies which lead to a sample of 97 companies for the regression analyses of the second hypothesis. All the comment letters sent by these 97 companies were divided in the several groups which were used as the explanatory variables in the regression analyses.

For the third hypothesis the data was not available during time of writing this thesis. This is mainly caused by the fact that it was not clear or easily accessible which banks and insurers adopted IFRS 9 voluntarily. Also the option for insurers given by the IASB to postpone the implementation of IFRS 9 did not help in collecting enough data. To solve this problem, I tried to collect data from specific countries where year-end reporting periods end on different dates. Since the mandatory implementation date is 1st January 2018, most companies which a different year-end date will implement after this mandatory date which is approved by the IASB since IFRS 9 should be implemented in fiscals years starting on or later than 1st January 2018.

Another option to gather data was to use the period reporting figures from banks. This caused a problem for Q1, since this period is very error sensitive because of the small time banks use IFRS

9 accounting rules. Also because these are only figures, I t will not give a clear view about the use of IFRS 9.

The last option was to use the financial figures of the second quarter of the year 2018. Since most banks report a full Q2 financial report, this could be compared with prior year to create a clear view of the use of IFRS 9. Unfortunately by the time of writing, these reports were not accessible yet because most banks report their Q2 figures during August. This creates a lack of data for the third hypothesis and seriously affected the outcome of this thesis.

For the analysis, I used QDA Miner, which is free available on the producer's website. This program help to analyze the word stems in the comment letters and indicate the sentences. For the analysis of the qualitative data used in multiple regressions, I used the analyzing program STATA, version 14, provided and taught by the Erasmus University.

4.4. Research conditions

This section describes the scientific conditions to which this thesis is exposed to and how I make sure these were examined properly and ensured during the research.

The internal validity is described in both hypothesis 1 and 2 by the relation between the change in the relevance or reliability component of the comment letters and the relation to the change of final standard compared to the first discussion paper. This relation is described by the total sum of all comment letters over the total change of the direction of the IASB. This is followed by an analysis of the relation between this percentage and the components BIG4, Financial company, and the amount of comment letters. These components describe the relation to influence. It is expected firms with Big4 auditors are more regulated by the rules and so are more dedicated to have influence. The urge for influence can be enhanced by the drive to make profit. More influence can be enhanced by sending more comment letters. This influence should explain a higher percentage of the total change in preference. Between these variables there is no plausible alternative explanation for this related covariation. For the third hypothesis all the variables used in the regression are a measure for accounting quality as described by Biddle, Hilary & Verdi (2009). The variables shows the change between period t-1 and period t, which are the testing periods before and after voluntarily adoption of IFRS 9. All these differences sum to the total difference in accounting quality between the two periods. This states that the cause which are the

variables and the effect which is the change in accounting quality are related. There is no alternative explanation for this relation since all variables calculate a difference which is summed up to a total difference.

The external validity is ensured by the fact that regarding the comment letters the whole population was used. Therefore it is possible to generalize the effect of comment letters on the standard making process. There should be a notification that although this is true for the comment letters, the standard setter is also influence by other forms of lobbying. As mentioned before, this cannot precisely be measured and analyzed due to the lack of data. Therefore this thesis is only covering the effect of the comment letters. This shortcoming should be included in the conclusion that the standard setter is not only influenced by comment letters. Therefore this thesis cannot be generalized to the total effect of lobbying activities to influence the IASB. For the third hypothesis, external validity could not be verified since data was missing and therefore this result could not be generalized. Although this creates a lack of significant result, the lack of data says something of the intentions of the companies to wait for the mandatory implementation date of IFRS 9 before the implement this new standard.

Construct validity is ensured by the assessment of the comment letters by the second observer. This way the subjectivity of the assessment is tested and excluded if the comparing results are negative. This is done by a third observer if subjectivity is concluded. In H1 the idea of influence is measured by the components and the difference variables which can change influential behavior. In H2 the change in comment letters related to the change in the standard is compared to the interests of different industry sub groups. This measures the idea of self-interest compared to their preferences. In H3 the construct validity is ensured by study of Biddle, Hilary & Verdi (2009). Since I followed their research methodology and this research is widely accepted, the model used in this research measures what is claims to be measuring. This caused a solid base for the construct validity of the model used in H3 in this thesis.

To explain the validity more clearly, I make use of the libby boxes which are included in the appendix. The idea of the libby boxes is to show the relation between both the conceptual and the operational forms of the explanatory variables and the explained variables. Please find the libby boxes for H1, H2 and H3 in appendix 1, 2 and 3.

The scientific reliability is covered by the fact that for H1 and H2 I use the whole population of comment letters, but again it must be said that this will only trigger a conclusion for the use of comment letters due to the fact of lack of data of other lobby activities. So the significant findings can be produced again by repeating the research. This should also be the case after the assessment of the comment letters is concluded to be done objectively or is corrected for subjectivity. For H2 the incentives for the different industries can vary among researchers and therefore compromise reliability, but I verified the industry-wide incentives in the existing literature to increase the objectivity for this assessment.

As mentioned before, there is a problem with the influence of other lobby activities. This will cause a endogeneity problem in this thesis. This problem is caused by the lack of data of other lobby activities which will result in an outcome where the explained variable will correlate with the error term. While I calculated in H1 and H2 the percent change of the comment letters compared with the change in the financial standard, the latter is influence by other variables which cannot be determined.

There is also an endogeneity problem in the relation between the personal incentives of the industry and their preferences in the comment letters. The preference is not only determined by incentives, but also by the accounting knowledge of the firms. While this is partly covered by the BIG4 variable in H1, it is not a hard evidence this will create more accounting knowledge.

Due to the lack of data for the third hypothesis, it cannot be said if there is an endogeneity problem between the variables and the error term. Since there are four control variables, the effect of the error term is expected to be smaller. Also the model is widely tested by Biddle, Hilary & Verdi (2009) which makes it more reliable to use without the expectations of endogeneity inclusiveness.

5. Results

In this section, the results of the analyses are presented. I also discuss the process to get to these results and give a description of the steps to be taken.

5.1. Influence of comment letters

As mentioned before, firms will only send comment letters and try to influence the standard setter if they think this will impact the direction of the standard setters preference. There is a tradeoff between relevance and reliability on which lobbyist should choose what he/she prefers. This preference can be in line with the standard setters opinion or against. It is therefore expected that the choice to choose for relevance or reliability and the way this will influence the standard setter is influenced if firms have a Big4 auditor and therefore have to comply to more extensive regulation. A second expectation is that the financial objective (profit or non-profit organizations) have a significant effect on the preference of the lobbyist and therefore try to influence the standard setter more. In this light I also expect most firms who send comment letters are profit driven, because they have a clearer incentive for influencing the standard setter. As a third expectation the amount of comment letters will have a significant effect on the influence of the standard setter by the lobbyist. I assume these relations will hold and show the effect on the percent variable representing the relation between the change of preference in comment letters and the change in preference in the final financial standard.

It was already noticed during the processing phase the data is not pointing in one direction. Some companies responded multiple times while they could be pro relevance (all comment letters sent by these parties mentioned relevance first) and pro reliability (all comment letters sent by these parties mentioned reliability first), but also change in opinion. This could be caused by a change of mind or because the phases differs in subjects. While most parties stayed with one preference, it is not totally clear why some parties in the population changed their minds.

To include this effect, I created two equal datasets based on all the comment letters. These datasets are outlined per company. The preference is indicated for every company in every phase. That way it is clear in which phase a company responded and what they preferred.

One of these datasets is focusing on relevance, where the reliability outcome was multiplied by -1 to indicate the trade-off between relevance and reliability. In the other dataset, this same was done for relevance to show the negative effect on reliability.

In every dataset both total outcome and average outcomes were taken. This is because not every company has sent equal amount of comment letters, so to correct for this disruptive effect, the average outcome were taken. This created 99 average numbers focusing on relevance and 99 average numbers focusing on reliability.

The next step in processing these data is to calculate the change in the IFRS proposals in the first Discussion paper and the final IFRS 9 standard. This change was calculated by count all the word stems and sum them for both relevance and reliability. This gives a total amount for both relevance and reliability word stems. This is divided by the total word count. This gives a small percentage of word count, but when I compare this to the other documents it should give an insight in change of preference. The outcome is presented in figure 1.

Figure 1: IFRS 9 preference outcome

	Relevance	Reliability
DP 2008	0,067%	0,041%
ED 2009	0,066%	0,056%
ED 2010	0,021%	0,062%
ED 2012	0,091%	0,016%
IFRS 9	0,081%	0,050%
Difference	21%	20%

It is noticed every DP or ED has a clear preference between relevance and reliability. This can be due to the subject of the different documents. As mentioned in paragraph 2, the discussion paper from 2008 focused on all three phases, while the exposure drafts from 2009, 2010 and 2012 all had different subject which could focused more on relevance or reliability.

The difference is calculated by the change in the first discussion paper (DP2008) and the final IFRS standard (IFRS 9). For relevance this gives a change of 21% and reliability changed with 20%.

These percentage are used as the denominator for equation 5 and 6. The nominator is the presented by the averages calculated before for every company for relevance in equation 5 and reliability in equation 6.

$$\text{(Big4; Financial; CL}_n) = \frac{\sum_{n=1}^{\infty} \Delta Inc\_Relv_{j,j+1}}{\Delta Relv_{j0,j+n}} \qquad \text{...(5)}$$

$$\text{(Big4; Financial; CL}_n) = \frac{\sum_{n=1}^{\infty} \Delta Dec\_Relv_{j,j+1}}{\Delta Relv_{j0,j+n}} \qquad \text{...(6)}$$

The other side of both equations are dummy variables. This data is collected manually for every company in the population. The 'BIG4' component is mostly based on the auditor's report in the financial statements of the company. For institutions it was often clear they were not audited by a Big4 firm. The 'Financial' component is based on the distinction between profit active companies and non-profit regulators or advice groups. Against the expectations, most companies were not profit active, but rather regulators or associations. As mentioned before this could bias the data, because profit active companies could be merged in associations which makes it unclear if this data is provided by profit active companies or another party. For this data, associations are classified as non-financial because the organization itself is not driven by financial activities. The 'CL$_n$' component stands for the amount of comment letters sent by a company, which was determined by counting the data per company.

For hypothesis 2, this also holds for the right hand side of equation (7) and (8).

$$\text{(Banking; Insurance; Advisory)} = \frac{\sum_{n=1}^{\infty} \Delta Inc\_Relv_{j,j+1}}{\Delta Relv_{j0,j+n}} \qquad \text{...(7)}$$

$$\text{(Banking; Insurance; Advisory)} = \frac{\sum_{n=1}^{\infty} \Delta Inc\_Relb_{j,j+1}}{\Delta Relb_{j0,j+n}} \qquad \text{...(8)}$$

In these equations, the left hand side is the distinction between industry groups: Banking, Insurance and Advisory. These groups are determined by the company's website and general knowledge. This subjective approach is verified by a second researcher.

5.2. Descriptive statistics for H1 and H2

The variables for the first hypothesis are described by the following statistics:

Table 1: Descriptive statistics H1

variable	Obs	Mean	Std. Dev.	Median	p25	p75	Min	Max
AC_relevance	99	.78	2.79	1.08	-1.56	3.53	-4.65	4.61
AC_reliabi~y	99	-.82	2.93	-1.13	-3.71	1.63	-4.84	4.88
BIG4	99	.39	.49	0	0	1	0	1
Financial	99	.39	.49	0	0	1	0	1
Amount_CL	99	1.57	.85	1	1	2	1	4

The AC_relevance and AC_reliabi~y variables are the calculated right hand side of equation (5) and (6) respectively. As described above, the total observations are 99 firms who send minimal 1 and maximal 4 comment letters. The means of AC_relevance and AC_reliability indicates the central tendency of the population of either of them strongly agree with the purpose of the comment letter. In other words, the comment letters which support relevance strongly implicates the population of these comment letters also support relevance, as expected. This also is true for the reliability component, which is a negative amount due to the trade-off between relevance and reliability.

It is curious the mean for the BIG4 and Financial components are both 0.39. This is caused by the fact that in the population all the profit driven companies have a BIG4 as auditor. This can be explained by the complexity and the size of all the profit driven respondents who prefer or are obliged to have a BIG4 auditor. This relation also causes that the standard deviation of these two components are exactly the same. The respondents who did not have a BIG4 auditor are nonprofit organizations and regulators, which form the largest group in the population. The mean of the Amount_CL variable indicates that in general companies had send 1.57 comment letters.

For the second hypothesis the descriptive statistics are described as follows:

Table 2: Descriptive statistics H2

variable	Obs	Mean	Std. Dev.	Median	p25	p75	Min	Max
AC_relevance	97	.80	2.75	1.08	-1.55	3.53	-4.65	4.61
AC_reliabi~y	97	-.84	2.89	-1.13	-3.70	1.63	-4.84	4.88
Banking	97	.60	.49	1	0	1	0	1
Insurance	97	.23	.42	0	0	0	0	1
Advisory	97	.18	.38	0	0	0	0	1

Due to the control on subjectivity for categorizing the organizations into the groups, there are 2 observations dropped. One of these observations could not be clearly grouped, the second dropped observation was dropped due to a difference between myself and the control researcher. The other organizations could clearly be grouped by the help of their websites and/or due to the general known objectives of these organizations. No other differences occurred between myself and the control researcher, which resulted in a population sample of 97 observations.

This changed the descriptive statistics slightly for the variables AC_relevance and AC_reliabi~y, but did not significantly changed compared to the H1 analysis.

From table 2 it is clear there was approximately 60 percent of banking related firms, 23 percent of insurance related firms, and 18 percent of advisory related firms who sent comment letters to the IASB. All other variable statistics are as expected.

5.3.Correlations between variables for H1 and H2

The correlations and the covariance are described as follows:

Table 3: Correlations between variables H1

	AC_relevance	AC_reliabi~y	BIG4	Financial	Amount_CL
AC_relevance	1.00				
AC_reliabi~y	-1.00	1.00			
BIG4	-0.19	0.19	1.00		
Financial	-0.22	0.22	0.87	1.00	
Amount_CL	-0.04	0.04	0.05	0.02	1.00

In table 3 it should be noticed that the variables AC_relevance and AC_reliabi~y are negatively correlated as opposite variables. This make sense since those are preference choices where a trade-off is made over the other. Due to this fact, the dummy variables also correlate with the same opposite amount on both explained variables.

As mentioned before, the BIG4 and Financial variables have the same value in the population. This causes a high correlation effect of 0.87 which can influence the outcome. Both these variables do not significantly correlate with the Amount_CL variable.

The following table described the correlations between the variables for the second hypothesis:

Table 4: Correlations between variables H2

	AC_relevance	AC_reliabi~y	Banking	Insurance	Advisory
AC_relevance	1.00				
AC_reliabi~y	-1.00	1.00			
Banking	0.12	-0.12	1.00		
Insurance	-0.007	0.007	-0.66	1.00	
Advisory	-0.15	0.15	-0.56	-0.25	1.00

Again the variables AC_relevance and AC_reliabi~y are negatively correlated as opposite variables due to their trade-off characteristics. This has also its effect on the correlations with these variables and the dummy variables. Further in table 2 the banking variables are correlating the highest with all other variables. This can be due to the high percent of observations compared to the total sample population. The insurance group is the second biggest group and correlates therefore as second highest with the other variables. For advisory group this also holds since it is the smallest group and correlates the least with the others.

5.4. Regression analysis Hypothesis 1

From this point, the data is ready to be processed in a multivariate regression analysis. This analysis is done twice, one for relevance components and the other for reliability components of the comment letters. The results are outlined below in Table 5 and Table 6 respectively.

Table 5: regression analysis relevance H1

Source	SS	df	MS			
Model	38.53	3	12.84	Number of obs	= 99	
Residual	724.58	95	7.63	F(3, 95)	= 1.68	
				Prob > F	= 0.176	
				R-squared	= 0.051	
				Adj R-squared	= 0.021	
Total	763.11	98	7.79	Root MSE	= 2.76	

AC_relevance	Coef.	Std. Err.	t	P>t	[95% conf. interval]	
BIG4	0.08	1.167	0.07	0.946	-2.24	2.40
Financial	-1.33	1.166	-1.14	0.258	-3.64	0.99
Amount_CL	-0.11	0.33	-0.33	0.745	-0.76	0.55
_cons	1.43	0.62	2.30	0.023	0.20	2.67

Table 6: regression analysis reliability H1

Source	SS	df	MS			
Model	42.48	3	14.16	Number of obs	= 99	
Residual	798.85	95	8.41	F(3, 95)	= 1.68	
				Prob > F	= 0.176	
				R-squared	= 0.051	
				Adj R-squared	= 0.021	
Total	841.33	98	8.59	Root MSE	= 2.90	

AC_reliability	Coef.	Std. Err.	t	P>t	[95% Conf. Interval]	
BIG4	-0.08	1.225	-0.07	0.946	-2.51	2.35
Financial	1.39	1.224	1.14	0.258	-1.04	3.82
Amount_CL	0.11	0.35	0.33	0.745	-0.57	0.80
_cons	-1.51	0.65	-2.30	0.023	-2.81	0.21

Both analyses are identical which is explained above, but this causes also both analysis are insignificant. For both analyses the probability is 0.176 which is above 5%.

When analyzing the outcomes, it stand out that only the error term (_cons) is significant with a t-value of 2.30 and -2.30. Both analyses show for all other dummy variables insignificant t-values in respect to the explained variables. This can be interpreted that firms are not having more influential power by having a Big4 auditor, the drive to make a profit, and the amount of comment letters. The latter is remarkable, because this was supposed in the existing literature. When lobbyist

would lobby more, the effect of their lobby activities would increase. With this outcome, it can be concluded this is not the case for lobbying through sending comment letters.

As expected the influential power is significant for the error term, which can be explained as other lobby activities which could not be measured. While it is unclear if any lobby activity is significant in the creating of a financial standard, it can be concluded that the comment letters could not do it alone. It is even unclear which part comment letters could play in convincing the standard setter, but from these results it can be concluded this is not significant. While Allen & Ramanna (2013) found a significant result for the comment letters in their study, based on these results it can be said that lobbyists' perceptions of the effectiveness of comment letters at creations of financial standards is based on their believes and not on any scientific prove.

As noticed in the descriptive statistics of H1 in table 1 the BIG4 and the Financial variables were identical to each other. That created a high correlation between those two variables which could influence the regression analyses. Now that it is concluded both variables are identical and that in this case they have the same purpose, the expectation is set that the regression analysis is weakened by this error. Therefore in table 5 and table 6 the analyses for both relevance and reliability are performed again, but this time without the BIG4 variable. The preference for eliminating the BIG4 variable over the Financial variable is being fed by the thought that profit driven firms need BIG4 auditors and not the other way around. Nonprofit organizations do not have a BIG4 auditor and so by eliminating this variable, the population is now divided by nonprofit organizations and profit driven organizations.

The following analyses are the result from this action:

Table 7: adjusted regression analysis relevance H1

Source	SS	df	MS		Number of obs	= 99
					F(3, 95)	= 2,55
Model	38,50	2	19,25		Prob > F	= 0,08
Residual	724,61	96	7,55		R-squared	= 0,050
					Adj R-squared	= 0,031
Total	763,11	98	7,79		Root MSE	= 2,75

AC_relevance	Coef.	Std. Err.	t	P>t	[95% conf. interval]	
Financial	-1,26	0,57	-2,23	0,028	-2,38	-0,14
Amount_CL	-0,11	0,33	-0,32	0,747	-0,76	0,54
_cons	1,44	0,62	2,32	0,022	0,21	2,67

Table 8: adjusted regression analysis reliability H1

Source	SS	df	MS		Number of obs	= 99
					F(3, 95)	= 2,55
Model	42,44	2	21,22		Prob > F	= 0,08
Residual	798,89	96	8,32		R-squared	= 0,050
					Adj R-squared	= 0,031
Total	841,33	98	8,59		Root MSE	= 2,88

AC_reliability	Coef.	Std. Err.	t	P>t	[95% Conf. Interval]	
Financial	1,32	0,59	2,23	0,028	0,14	2,50
Amount_CL	0,11	0,34	0,32	0,747	-0,57	0,79
_cons	-1,51	0,65	-2,32	0,022	-2,80	-0,22

These new analyses show a much lower F-statistic (probability). Unfortunately these are also not significant on the 5% certainty level since the F statistic is 0,08. Although this is not significant on a 5% level, it can be said that the underlying null hypothesis (in which the coefficients of the independent dummy variables are equal to zero) can be rejected with a 92% certainty. In other words, it can be assumed with a 92% certainty this model is valid.

It should be said that in both the first two analyses as in the second two, the R-squared remains relatively constant meaning that the percent of variance explained is not changed in these two models. Notice that the adjusted R-square does increase, meaning the goodness of fit of the

independent variables get higher, which is just the explanation of eliminating on of the variables between the two analysis sets.

Another change compared to the first two analyses is the t-value for the Financial variable. In these two analyses this variable is significant which implicates that profit driven companies have more influence by persuade the standard setter. This can be explained by the fact that the incentives for the profit driven companies are supported by their own personal gains and losses in comparison to nonprofit organizations who are driven by the common good. This lower t-value is caused by the lower values of the standard error for the Financial variable. This can be explained by the correlating effect between the BIG4 and the Financial variables. Since this effect is excluded in these adjusted analyses, the standard error is also decreased. Also the p-value for this variable is now significant (0,028 < 0,05).

The Amount_CL variable still remains insignificant which implies it does not matter how many comment letters were sent to the standard setter. Therefore the first conclusion holds as standard setters are not influenced by the comment letters, but companies send them anyway. Therefore the conclusion that lobbyists' perceptions of the effectiveness of comment letters at creations of financial standards is based on their believes and not on any scientific prove, still holds. Also as expected, the error term is still significant and increased a little, indicating the influence of other lobbying techniques has still more power than lobbying with comment letters.

This confirmed the hypothesis that banks and financial institutions have a significant impact on the accounting standard setting process. It should be said that although profit driven companies have more influence than nonprofit organizations by sending comment letters, it does not mean nonprofit organizations have no influence. Also the amount of comment letters do not significantly influence the standard setter, but other lobbying techniques in solitude or combined do have an influence. In the following analyses it should be clear if sending at least one comment letter by lobbyists work truly in their favor or is just a perception.

5.5. Regression analysis Hypothesis 2

For hypothesis 2 the data is also analyzed with a multivariate regression analysis. This analysis is also done twice, again one for relevance components and the other for reliability components. The results are outlined below in Table 9 and Table 10 respectively.

Table 9: regression analysis relevance H2

Source	SS	df	MS			
Model	17.86	2	8.93	Number of obs	= 97	
Residual	710.46	94	7.56	F(3, 95)	= 1.18	
				Prob > F	= 0.311	
				R-squared	= 0.025	
				Adj R-squared	= 0.004	
Total	728.31	96	7.59	Root MSE	= 2.75	

AC_reliability	Coef.	Std. Err.	t	P>t	[95% Conf. Interval]	
Banking	1.16	0.76	1.54	0.128	-0.34	2.67
Insurance	0,85	0.89	0.96	0.339	-0.91	2.62
_cons	-0.09	0.67	-0.13	0.894	-1.41	-1.23

Table 10: regression analysis reliability H2

Source	SS	df	MS			
Model	19.69	2	9.84	Number of obs	= 97	
Residual	783.28	94	8.33	F(3, 95)	= 1.18	
				Prob > F	= 0.311	
				R-squared	= 0.025	
				Adj R-squared	= 0.004	
Total	802.96	96	8.36	Root MSE	= 2.89	

AC_reliability	Coef.	Std. Err.	t	P>t	[95% Conf. Interval]	
Banking	-1.22	0.80	-1.54	0.128	-2.80	0.35
Insurance	-0.90	0.93	-0.96	0.339	-2.75	0.95
_cons	-0.09	0.70	0.13	0.894	-1.30	1.48

Both analyses are insignificant according to the probability factor of 0.311. This can be caused by the low amount of observations, but since this is a big part of the total population of 99 different companies, this insignificance is accepted.

Also in both analyses the dummy variable Advisory is excluded to avoid the dummy variable trap in which there is multicollinearity between all the dummy variables. I choose to exclude the smallest dummy variable, because this should have the least impact on the model. This resulted in two regression analyses in which the two other dummy variables, banking and insurance were regressed over the average count of relevance and reliability.

The results are all insignificant since in both models the p-value of all the variables is greater than 0.05. This could mean the entire industries of both banking and insurance are not following an specific line of argument within the comment letters. The trade-off which should be made is not pointing in one direction in these industries. It should be said this conclusion is not entirely significant since the 95% interval for all variables includes zero, which means the zero hypothesis can also be true in which the variables does not have a meaning at all. This could imply the comment letters were sent by multiple companies who did not think the same about certain topics. Also it is possible since sending comment letters is not really a strong lobbying technique what could be concluded from hypothesis 1, companies are focusing much more on other lobbying activities which are out of scope in these last two analyses. This could explain the insignificant results for each industry, since comment letters are not really united in this industry. Other lobbying activities could be more set up from the industry itself instead of separate companies. So from this it can be concluded that hypothesis 2 is not true for the comment letter technique. The effect of lobby activities of the financial industry on accounting standard setters is not motivated by favorable incentives for the financial industry when it come to the use of comment letters. However it is believed the separate companies in the banking and insurance industry still send comment letters from a self-interest point of view as this can general be assumed from the agency theory.

As mentioned before, although the results are insignificant, comment letters are the best and only way to observe lobby activities. It is known lobby activities did occur during the creation of IFRS 9 which could alter the accounting quality. The next sections will try to answer hypothesis 3 by analyzing the effect on accounting quality in companies who adapted IFRS 9 voluntarily.

5.6. Analysis Hypothesis 3

Although the IASB has the objective to enhance the accounting quality by setting standards and try to improve them along the way, they are influenced by lobby activities and political pressure as mentioned before. This could affect the accounting quality. In this section the change in accounting quality should be observed during the voluntarily adoption period from 2015 until 1 January 2018. As mentioned before, this should be done by four proxies, namely accrual quality, a modification on accrual quality, financial disclosure transparency and a combination of all three.

Unfortunately it was not clear which banks and insurers voluntarily adopted IFRS 9 before the mandatory implementation date of 1 January 2018 as the data was not generally known. As an extra impact on this thesis, in 2015 the IFRS decided to defer the implementation of IFRS 9 for insurers whose predominant part of total liabilities were within scope of IFRS 4 (EY, 2015; PwC, 2015). This deferral includes an option for insurers to postpone the implementation of IFRS 9 until the effective date of the new insurance contracts standard. This option will expire on or after 1 January 2021 which means insurers should then implement this new insurance contracts standard, otherwise IFRS 9 should be implemented. As mentioned above, insurers will only be qualified for this option if a predominant part of their business is devoted to the activity of issuing contracts within the scope of IFRS 4. The IASB felt that 'predominant' would indicate a good measure as she did not want to set a fixed percentage. As a result, the IASB includes examples to outline this predominance. Some board members argued this would lay more complexity to the assessment of issuing IFRS 9. The requirement of 'predominance' is in practice difficult to meet for insurers that have a large amount of investment contract liabilities in the scope of IFRS 9 instead of IFRS 4. These entities could still use the overlay approach. This made the implementation of IFRS 9 more complex as the calculations required to implement it are difficult to perform for the companies themselves. According to the article of EY, this will particularly be the case if the accounting for insurance contract liabilities is affected by the amount of investment income recognized in profit and loss (EY, 2015).

This posed a problem for data gathering since it is not clear which insurers used the option to defer and which insurers used the overlay approach. Also since insurers were not happy with the implementation of IFRS 9, none of them would voluntarily adopt this standard. Although there is no data available for this yet, it is know from my previous hypotheses that during the comment letters period insurers were not happy with the proposals since it influenced them negatively. Although hypothesis 2 indicated insurers (and other tested industries) did not have a common goal, hypothesis 1 indicated profit driven companies have a significant influence on the standard setter. In this case, although it is not based on quantitative research, it can be slightly concluded that the lobbying by sending comment letters did not resulted in higher accounting quality for insurers. This is because the complexity of the overlay approach and the qualification for the defer option made the accounting quality less reliable. Due to the complex calculations which should be made to

implement the appropriate standard, the accounting figures are harder to understand and more difficult to trace back to the source documentation.

This defer option did not exist for banks and since they are obliged to implement IFRS 9 on 1 January 2018 it was expected some of them would implement IFRS 9 voluntarily. Unfortunately this data was not easily accessible since most banks would not change voluntarily their accounting practice from IAS 39 to IFRS 9 as this would bring big changes and increased implementation costs.

I did find some banks, especially in Canada, who voluntarily implement IFRS 9 partially for their credit rating departments. Although this gave some usable data, during the structuring of the data it became clear these credit rating departments and the implementation phases differ too much to compare in a regression analysis. There was also not enough data to fully perform a regression analysis on this section.

At the time of writing banks already mandatory adopted IFRS 9 since 1 January 2018. As many banks report quarterly, this could give an opportunity to change the model of hypothesis 3 and use the data of one of the quarters. For most banks, the Q1 report only give representational numbers. As IFRS 9 was implemented only 3 months ago, this would not give a faithful analysis since a lot of mistakes still existed. Therefore the only report usable for this thesis at the time of writing is the Q2 report which includes a more detailed outline of the financial figures and six months of data which could be compared to the same six months in prior year. Unfortunately this data was also not available since most banks report their Q2 figures in Mid-August.

Due to the lack of data and the lack of a reasonable explanation as it was given for insurers, there could nothing significantly be concluded for banks in terms of the accounting quality of IFRS 9. As it is known from hypothesis 1 that profit driven firms have a significant influence on the standard setter, it is believed after this research many banks did not implement IFRS 9 voluntarily. This can be partially explained by the outcome of hypothesis 2. Since companies within the same industries has not a common goal, it could also not expected this whole industry follow the same approach. As a result, banks waited and prepared for the mandatory implementation of IFRS 9.

5.7. Summary

The results pointed out that profit driven firms do have a significant influence on the standard setter as researched by the first hypothesis. Non-profit driven firms do not have this influence, which can be explained by their lack of exceeding gains over the costs. This balance is more positive for profit-driven firms since their income could be affected by these new standards. The second hypothesis examined the industry wide strategy for the banking, insurance and advisory industry and the trade-off choice within these industries for relevance or reliability. The multivariate regression analyses gave not significant results which means there is no clear common strategy within these industries and therefore no common incentives to lobby for. The third hypothesis could not be quantitative examined because of the lack of data. Although this affect this thesis, it could be said for insurers the accounting quality is decreased because of the complex calculations needed to qualify for the deferral option. For banks this slight conclusions explained by the lack of data could not be given since they do not have this option.

6. Conclusion

This thesis examined the influence of lobby activities by the financial industry on the creation of IFRS 9. This was done by answering of three sub-questions which in the end should give an answer on the research question. The first sub-question examined the influence of lobbyists. Lobbyists were divided into profit driven firms and non-profit driven firms. This resulted in a significant influence of the profit driven firms and a non-significant result for the non-profit firms. From this result if can be concluded that profit driven firms has an influence on the standard setter regarding the creation of IFRS 9. This conclusion is in line with previous research.

The second sub-question tried to answer if companies with the same characteristics shares the same ultimate goal in their lobby strategy. From the results it was clear this was not the case. When dividing the sample of companies who sent comment letters in sub-groups (Banking, Insurance, and Advisory), none of the sub-groups showed a significant strategy within those groups by making the trade-off between relevance and reliability. Therefore it can be concluded companies within the same industry do not follow a common industry shared strategy when it comes to sending comment letters.

The third sub-questions tried to find a relation between the implementation of IFRS 9 and the eventually increased or decreased accounting quality. Due to lack of data, there was no clear answer regarding this sub-question. Although it is not significantly proved, for the insurers, who accomplished by their lobby activities to postpone the IFRS 9 implementation, it can be said the accounting quality decreased due to the more complex calculations needed to qualify for the deferral option. It is assumed this decrease the reliability of the financial statements due to higher change of errors. Unfortunately for banks, such a slight conclusion could not be made since they were obliged to implement IFRS 9 without such a deferral option. The lack of data made it not possible to conclude on this sub-question.

The research question was:

Will the quality of accounting standards be affected by the lobby activities of the financial industry which are motivated by self-interested incentives?

Due to the limitations of this thesis a clear conclusion cannot be given. From the first and second sub-questions it can be concluded the lobby activities indeed has an effect on the quality of accounting standards since profit driven lobbyists have influence. From prior literature it is clear lobbyists only lobby when they expect the incentives exceeds the costs. It can be said that lobbyists are motivated by self-interested incentives although this thesis showed this means it can also be the perception of the lobbyists since in this thesis there were no industry wide incentives shared by the companies within a specific industry. Although it can be concluded the accounting quality is influenced by accounting standards and the perception of fulfilling self-interested incentives, it cannot be said in which way accounting quality of the standards is affected by this due to the limitations within this thesis.

A big limitation of this thesis is the lack of lobbying data. It is said earlier comment letters are the best way to assess the lobbying activities, because it is the only observable source of lobbying activities. This created a lack of view of the total lobbying influence on the standard setter. Although the full population of comment letters send for IFRS 9 was used within this thesis, it is a small part of the total lobbying activities.

A second big limitation is the lack of financial statements using IFRS 9 by the time of writing. It was expected a sufficient amount of banks and other financial institutions voluntarily adopted IFRS 9, but by the time of collecting it was clear most banks waited and prepared slowly until the mandatory date was applicable. By the time of writing banks were already mandatory switched to IFRS 9 but unfortunately there were no usable financial statement figures available. This had a big effect on this thesis since the third sub-question about the accounting quality of IFRS 9 could not be answered and therefore a clear conclusion on the research question is missing.

Future research could use this thesis for the effect on IFRS 9 by lobbying activities, but should wait for the first year-end financial statements after the implementation of IFRS 9. This would give a possibility to perform an event study and see the effect of IFRS 9 on the accounting quality. Another recommendation for future research into the effect of lobbying activities is the collection of qualitative data from lobbyist organizations to expand the research into the effect on lobby activities and that way minimize the effect on the error term in the model. Although this is hard and not easily collected, lobbyists could be better understood in their search for influence within the standard setters choice by creating a new accounting standard like IFRS 9.

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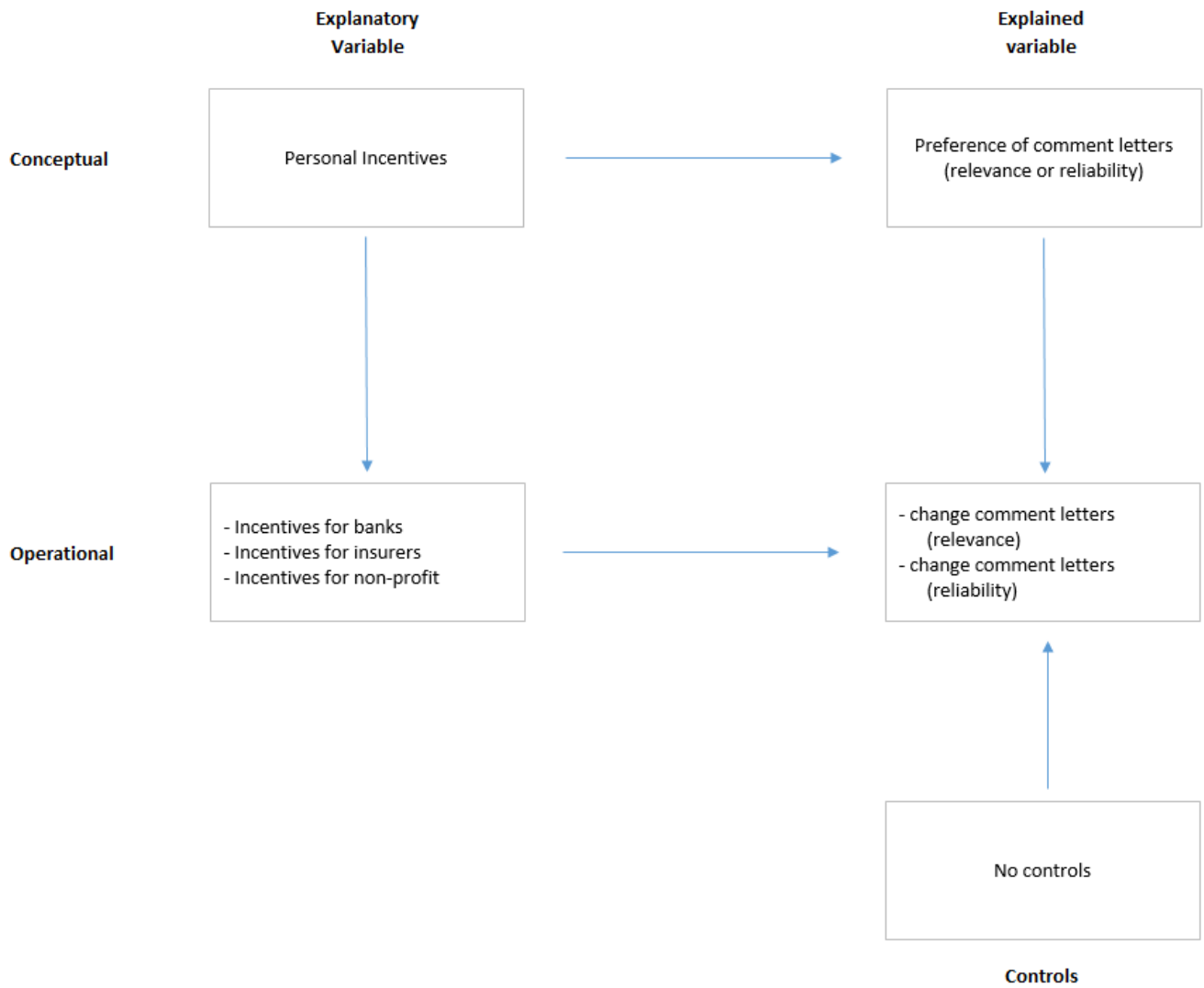
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Appendix 1 – Libby box H1
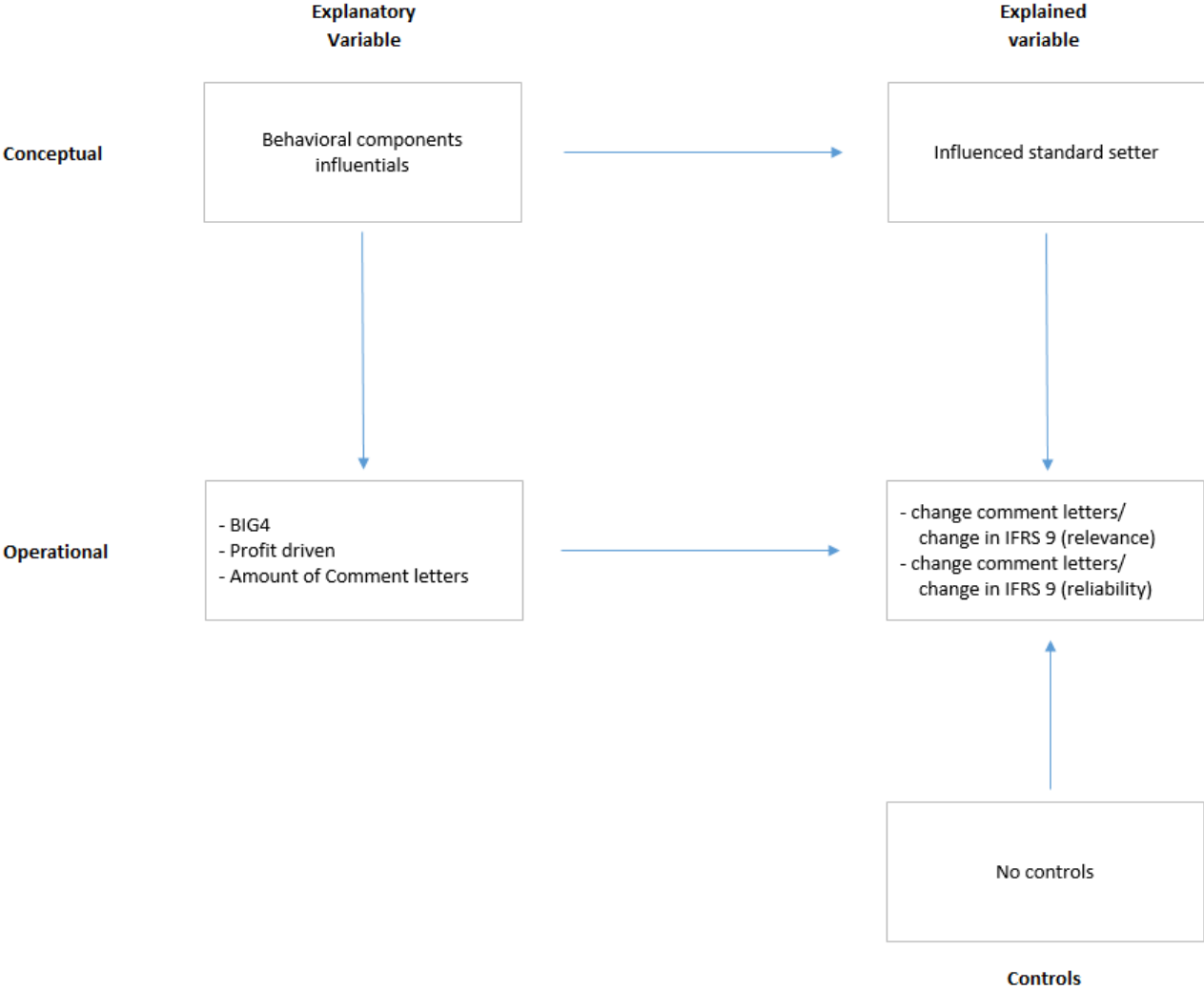
Appendix 2 – Libby box H2

Appendix 3 – Libby box H3